THE CONNECTICUT
ECONOMIC DIGEST

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JUNE 2012

IN THIS ISSUE...

In April...

Nonfarm Employment

Connecticut 1,628,800
Change over month .... -0.25%
Change over year .... -0.1%

United States 132,989,000
Change over month .... +0.09%
Change over year .... +1.4%

Unemployment Rate

Connecticut 7.7%
United States 8.1%

Consumer Price Index

United States 230.1
Change over year 2.3%

Drag Forces From Balance Sheet Recession Still Constrain Growth: The Employment Outlook to 2013

By Daniel W. Kennedy, Ph.D., Senior Economist, DOL, Daniel.Kennedy@ct.gov

Drag is the aerodynamic force that opposes an aircraft's motion through the air.[1] If for our analogy, we cast the aircraft as the economy, then the *drag force* on the economy is the $16.4 trillion collapse in net worth of U.S. households between 2007Q2 and 2009Q1. As of the fourth quarter of 2011, U.S. household net worth was still down $8.4 trillion from its peak. Further, the net worth of non-incorporated businesses was still down $2 trillion from its peak, also in 2007Q2.[2] As noted in *The Outlook to 2012*, the recent downturn was no "ordinary" recession, and this is not a "normal" recovery. This recovery not only followed a financial panic, but also the first popping of asset bubbles in housing and the stock market, in conjunction with unsustainable levels of household debt since the 1920s.[3] This wiped out the net worth of a significant number of households, as well as unincorporated businesses, leaving in its wake what has been called a *Balance Sheet Recession.*[4] Balance sheet recessions are steeper and last longer than non-balance sheet recessions, and they are followed by weaker recoveries[5] as households reduce their spending and pay down debt to repair their net worth.

Another drag force on the economy is the winding down of the American Recovery and Reinvestment Act (ARRA) stimulus. As a consequence, the recovery (which began officially in June 2009), has proceeded in fits-and-starts. This is especially reflected in the loss of 586,000 government jobs between June 2009 and March 2012, even as the private sector steadily added jobs. Of these, 492,000, or 84%, of those lost jobs were local government, as ARRA stimulus support for maintaining employment levels of teachers and public safety workers was withdrawn. This compared to the 309,000 government jobs added over the first 35 months of recovery from the 2001 recession, and the 659,000 government jobs added coming out of the 1990-91 recession. This pattern is true for Connecticut as well: between the State's jobs recovery in February 2010 and March 2012, the latest data available at writing, the State had lost 9,100 government jobs. Three-quarters of the jobs lost were in local government.[6] Connecticut, like the U.S., added government jobs over the previous two recoveries.

MANUFACTURING RENAISSANCE?

Since Connecticut's job growth turned the corner in February 2010 to March 2012, the State's manufacturing sector has added 600 new jobs. When compared to 25 months into the other two post-

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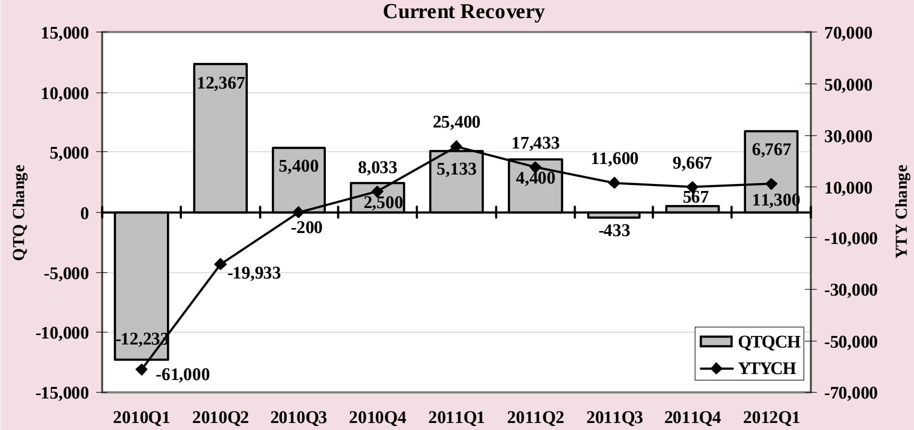
Cold War recoveries: the State lost another 3,700 manufacturing jobs after turning the corner in September 2003, and another 15,200 jobs after the trough in December 1992. The growth was concentrated in durable goods, which added 700 jobs, while nondurable goods subtracted 100 jobs. In addition to export growth, Connecticut may be indirectly benefitting from the renaissance in the auto industry after the U.S. government provided loans and bought a stake in GM and Chrysler in 2009. Connecticut added 625 jobs in fabricated metals, 443 in miscellaneous manufacturing, and 173 in primary metal. In addition, 109 jobs were added in plastics and rubber (nondurable goods). Only computers and electronics subtracted jobs (-225). These industries have all been identified as having significant intermediate (i.e., indirect) employment-multiplier effects from activity generated from motor vehicle production.[7]

THE ECONOMY'S "ARAB SPRING"

Whether due to the record warm winter, or the extension of the payroll tax cut, which is estimated to have supported 4,900 jobs in Connecticut and prevented a 0.2 percentage-point increase in the unemployment rate,[8] the U.S. and Connecticut economies had what could be dubbed their "Arab Spring" over the final months of 2011 and into the beginning of 2012. Concerns about how real the momentum was began to surface with the advance GDP release by the U.S. BEA, which showed that growth significantly decelerated over the first quarter of 2012. Job growth began to decelerate for the U.S. in March and April (although revisions were upward), and Connecticut shed 2,700 jobs in March, after adding 6,000 jobs in February. Nevertheless, as depicted in Graph 1, on a more stable quarter-to-quarter basis Connecticut had a surge in job growth of 6,767 in the first quarter of 2012, compared to the negative then flat growth over the last two quarters of 2011.

What drove the first-quarter growth? On a monthly basis, between December and March, Connecticut added 8,700 jobs. Private, nonfinancial services added 6,400 jobs, followed by the goods producing sector which added another 3,400 jobs, while the financial (-300) and government (-800) sectors subtracted jobs. Most striking, besides the 800 new jobs in manufacturing (discussed above) are the new 2,600 construction jobs. The trend-driven health care and social assistance (HCSA) sector dominated growth in the nonfinancial services sector, adding 3,000 jobs. Both nationally and in Connecticut, demographics are pushing the growth of this sector, resulting in

GRAPH 1: QTQ and YTY Change in CT Nonfarm Employment: Current Recovery



Connecticut Nonfarm Employment: History and Forecast

INDUSTRY	HISTORICAL			FORECAST	NUMERICAL CHANGES			PERCENT CHANGES		
	2007:Q4	2009:Q4	2011:Q4	2013:Q4	CH07-09	CH09-11	CH11-13	%CH07-09	%CH09-11	%CH11-13
TOTAL	**1,723,099**	**1,627,571**	**1,644,318**	**1,666,575**	**-95,528**	**16,748**	**22,256**	**-5.54**	**1.03**	**1.35**
GOODS PRODUCING………………………………	**261,873**	**221,030**	**220,120**	**218,403**	**-40,843**	**-910**	**-1,718**	**-15.60**	**-0.41**	**-0.78**
Mining………………………………………………………	747	610	571	537	-137	-39	-34	-18.38	-6.34	-5.95
Construction………………………………………………	70,464	53,851	53,507	55,140	-16,612	-344	1,633	-23.58	-0.64	3.05
Manufacturing……………………………………………	190,663	166,569	166,042	162,726	-24,094	-527	-3,316	-12.64	-0.32	-2.00
SERVICE PROVIDING………………………………	**1,445,786**	**1,391,692**	**1,410,186**	**1,434,043**	**-54,094**	**18,494**	**23,857**	**-3.74**	**1.33**	**1.69**
Wholesale Trade………………………………………	68,279	63,896	64,020	65,219	-4,382	124	1,199	-6.42	0.19	1.87
Retail Trade……………………………………………	197,254	183,101	185,633	186,661	-14,152	2,532	1,028	-7.17	1.38	0.55
Transportation and Warehousing……………………	53,951	49,470	49,540	50,341	-4,481	70	801	-8.31	0.14	1.62
Utilities………………………………………………………	6,685	6,590	6,038	5,581	-95	-552	-457	-1.42	-8.38	-7.56
Information………………………………………………	38,133	34,020	31,241	30,025	-4,113	-2,779	-1,215	-10.79	-8.17	-3.89
Finance and Insurance………………………………	122,866	116,718	113,751	111,511	-6,148	-2,968	-2,239	-5.00	-2.54	-1.97
Real Estate and Rental and Leasing………………	20,937	18,962	18,599	17,596	-1,975	-363	-1,003	-9.43	-1.91	-5.39
Professional, Scientific, and Technical Services….	93,019	85,457	88,646	91,673	-7,562	3,189	3,027	-8.13	3.73	3.41
Management of Companies and Enterprises……….	27,076	27,163	28,880	29,638	87	1,718	758	0.32	6.32	2.62
Admin and Support/Waste Manage/Remediation..	90,404	76,720	83,116	87,145	-13,684	6,396	4,029	-15.14	8.34	4.85
Educational Services…………………………………	177,587	179,324	180,514	183,436	1,736	1,190	2,922	0.98	0.66	1.62
Health Care and Social Assistance…………………	255,936	265,645	272,408	284,082	9,709	6,763	11,674	3.79	2.55	4.29
Arts, Entertainment, and Recreation……………….	42,540	40,607	39,434	39,804	-1,934	-1,172	370	-4.55	-2.89	0.94
Accommodation and Food Services……………….	113,137	110,083	115,442	118,876	-3,054	5,359	3,434	-2.70	4.87	2.97
Other Services…………………………………………	58,648	56,556	57,160	58,068	-2,092	604	907	-3.57	1.07	1.59
Government**……………………………………………	79,334	77,380	75,763	74,386	-1,954	-1,617	-1,376	-2.46	-2.09	-1.82

SOURCE: Connecticut Department of Labor, Office of Research NOTE: Data not seasonally adjusted

****State and local-government employment did not actually increase by 29,769 between 2007Q4 and 2009Q4.**

Reporting requirements changed, which caused a jump in jobs reported by the State and local governments.

its growing consistently over all phases of the business cycle. Retail added 1,100 jobs, dominated by motor vehicles and parts, and particularly new car dealers (see discussion on manufacturing and the auto industry above). General merchandise and building materials also significantly contributed to the growth in retail jobs. Professional and scientific, driven by computer systems and design, added 800 jobs, and wholesale trade and education each continued to add jobs. All other industries in the nonfinancial services sector subtracted 500 jobs between December 2011 and March 2012.

THE OUTLOOK FOR 2011-2013

Forecast of Annual Average Employment: 2012 and 2013

Over the two recent recession years, Connecticut's job growth was flat in 2008, followed by a steep contraction of 72,400 jobs in 2009. Even though the State's employment recovered in February 2010 on an annual basis, Connecticut's economy shed another 18,600 jobs in 2010. Then in 2011, the State added 15,500 jobs on an annual basis for the first time since 2008, and the strongest showing since 2007. The forecast expects continued growth over the two year horizon. However, growth in the annual average level of jobs is projected to decelerate to approximately 14,000 over the 2011-2013 two-year forecast horizon.

Forecast of 2011Q4-2013Q4

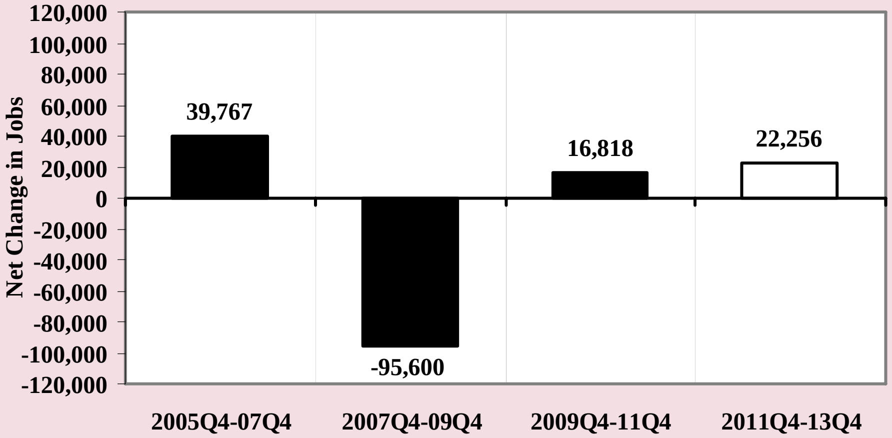
The above table contains the details by NAICS sector for the fourth quarter-to-fourth quarter (4Q-to-4Q) forecasts for the 19 major, two-digit nonfarm sectors. Graph 2 refers to the two-year forecast period 2011Q4 to 2013Q4. For reference, two 2-year historical periods are also included in Graph 2.

The last period before the recent crisis and recession was the 2005Q4-2007Q4 period. Over that eight-quarter period, Connecticut added nearly 40,000 jobs. With the onset of financial crisis and the subsequent severe recession, the State's economy shed nearly 96,000 jobs between 2007Q4 and 2009Q4. With the State's recovery underway after February 2010, Connecticut added nearly 17,000 jobs between 2009 and 2011, 4Q-to-4Q, which is the base period for the forecast. The forecast calls for the State's economy to add another 22,000 jobs over the eight-quarter forecast period. The first half (2011Q4-2012Q4) of the 2011Q4-2013Q4 forecast period should account for a larger share of the job growth over the eight-quarter forecast period, as it is expected that job growth will slow over the second half (2012Q4-2013Q4) of the forecast period.

It is expected that the private, nonfinancial services sector will be the only major sector that will add jobs over the forecast period, creating 28,500 new jobs over the 2011Q4-2013Q4 forecast horizon. Government (-1,376), goods producing (-1,718), and the financial services sector (-3,242) are all expected to subtract jobs from the economy between 2011Q4 and 2013Q4.

Within nonfinancial services, no sector that added jobs over the 2009Q4-2011Q4 base period is expected to shed jobs over the forecast period. On the other hand, there are two sectors that lost jobs over the base period that are expected to add jobs over the forecast period: construction

GRAPH 2: 4th Qtr-to-4th Qtr Two-Year Changes in CT Jobs-History and Forecast: 2005-2013



(+1,633) and arts and entertainment (+370). Seven sectors that had job losses over the base period (2009Q4-2011Q4) are also expected to subtract jobs from the State's economy over the forecast period. Mining is projected to shed another 34 jobs. Manufacturing, though experiencing a renaissance over the current recovery—especially in durable goods—is expected to shed jobs again, especially over the last half of the forecast period (2012Q4 to 2013Q4). Utilities (-457), information (-1,215), and the entire financial services sector (finance and insurance and real estate) are expected to eliminate jobs. Government is expected to continue losing jobs over the forecast period (especially local government), eliminating another 1,376 jobs between 2011Q4 and 2013Q4.

There are 10 two-digit NAICS sectors that added jobs over the base period that are also expected to add jobs over the forecast period. Seven of those 10 sectors are expected to add 1,000 or more jobs each between 2011Q4 and 2013Q4. Leading the way is the health care and social assistance (HCSA) sector, which has been driven by trend-dominated growth propelled by demographics as the large baby boom generation has been aging. After adding 6,763 jobs over the base period (2009Q4-2011Q4), HCSA is expected to add 11,674 new jobs between 2011Q4 and 2013Q4. This is especially true for Connecticut whose median age at 40.0 years old is 2.9 years higher than that for the U.S., and with 14.2% of its population over 65, compared to 13.0% for the U.S.[9] The next most significant contribution to the forecast is the 4,029 jobs that administration and support and waste management (admin/support) is projected to add over the forecast horizon. This sector's growth is driven by employment services, NAICS 56130, which accounts for from one-quarter to one-third of the level of admin/support employment, but can account for most or even all of the sector's job growth, as the economy has moved more toward the use of contingent workers. This works in reverse when the economy contracts. And, this series may be evolving as a critical leading indicator. The year-to-year (YTY) growth in temporary help had decelerated in the last quarter of 2011, but then accelerated in the first quarter of 2012. Accommodation and food services is expected to add another 3,434 jobs over the 2011Q4-2013Q4 forecast period after adding 5,359 jobs over the 2009Q4-2011Q4 base period. This growth has been and is expected to be dominated by NAICS 722, food services, particularly eating and drinking places. This seems to be driven by lifestyle factors. Professional, scientific, and technical services (prof-tech) is projected to add another 3,027 jobs over the forecast period to the 3,189 jobs added over the base period. Job growth as well as decline over the business cycle in the prof-tech sector have been driven by computer systems and design employment (NAICS 5415), as well as legal (NAICS 5411) and management consulting (NAICS 5416). Educational services, mostly private sector, is expected to add 2,922 jobs between 2011Q4 and 2013Q4. Wholesale trade (+1,199) and retail trade (+1,028) are also projected to add more than 1,000 jobs each over the forecast period. Retail has been particularly driven by the resurgence of consumer durables sales over the current recovery, particularly in the last half of 2011 and the first quarter of 2012. Consumer durables, in turn, have been driven by employment increases in NAICS 4411, new car dealers. In Connecticut's surge in early 2010, NAICS 4451, grocery, had been strong, but employment growth turned negative going into 2011 as Shaw's pulled out of the State and Stop & Shop closed a warehouse.

RISKS TO THE FORECAST

There are significant downside risks to the forecast. The housing sector is still down from the popping of the bubble and continued foreclosures, and consumer debt is still high (and student loan debt may be the next financial crisis). Depressed asset values and high debt loads mean that households and unincorporated businesses are still rebuilding their net worth which will act as a continued drag on the economy. With talk of fiscal austerity winning the day, and no new fiscal stimulus on the horizon, growth will proceed in fits-and-starts. The Eurozone crisis may yet finally plunge the world back into financial crisis. Further, U.S. banks are not insulated from a financial crisis in Europe. They increased their sales of credit default swaps (CDS), essentially writing insurance against credit losses to holders of EU sovereign debt in the first half of 2011, boosting their risk exposure.[10]

The second half of the forecast period (2012Q4-2013Q4) is the most uncertain part of the forecast. In addition to political uncertainty until after the November elections, and the expiration of the extensions of the Bush tax cuts, temporary payroll-tax holiday, and extended unemployment insurance benefits, unless Congress kicks the proverbial can down the road, *The Budget Control Act of 2011* could potentially push the economy over a cliff in 2013.[11] The spending cuts scheduled to take effect because of the failure of the so-called "super committee" last November will take us down the same road as the United Kingdom, which has been plunged back into recession as a consequence of draconian budget austerity measures.

On the positive side, gasoline prices have been declining for about three weeks at the time of writing. This acts as a progressive tax cut which can stimulate the economy. Private sector job creation has been slow but steadily growing even as government, especially local government, has been a drag on the economy. And the extension of the temporary payroll tax reduction, an actual progressive tax cut, has apparently helped support consumer spending over the economy's "Arab Spring." ■

NOTE: *The author would like to thank economists Matthew Krzyzek and Sarah York for their research assistance on this article.*

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GENERAL ECONOMIC INDICATORS

(Seasonally adjusted)	1Q 2012	1Q 2011	CHANGE NO.	CHANGE %	4Q 2011
General Drift Indicator (1986=100)*					
Leading	NA	NA	NA	NA	NA
Coincident	NA	NA	NA	NA	NA
Farmington Bank Business Barometer (1992=100)**	125.2	125.0	0.2	0.2	125.3
Philadelphia Fed's Coincident Index (July 1992=100)***	**APR**	**APR**			**MAR**
(Seasonally adjusted)	**2012**	**2011**			**2012**
Connecticut	160.72	155.70	5.02	3.2	160.35
United States	152.56	148.24	4.32	2.9	152.16

*Sources: *The Connecticut Economy, University of Connecticut **Farmington Bank ***Federal Reserve Bank of Philadelphia*

The Connecticut Economy's **General Drift Indicators** are composite measures of the four-quarter change in three coincident (Connecticut Manufacturing Production Index, nonfarm employment, and real personal income) and four leading (housing permits, manufacturing average weekly hours, Hartford help-wanted advertising, and initial unemployment claims) economic variables, and are indexed so 1986 = 100.

The **Farmington Bank Business Barometer** is a measure of overall economic growth in the state of Connecticut that is derived from non-manufacturing employment, real disposable personal income, and manufacturing production.

The **Philadelphia Fed's Coincident Index** summarizes current economic condition by using four coincident variables: nonfarm payroll employment, average hours worked in manufacturing, the unemployment rate, and wage and salary disbursements deflated by the consumer price index (U.S. city average).